MICROFINANCE FOR AFGHANISTAN'S AGRICULTURAL SECTOR

Since 2003, the RAMP-supported **Microfinance Investment and Support Facility - Afghanistan (MISFA)** has made substantial progress in meeting the demand for microfinance services in Afghanistan, estimated at more than two million households. The need for formal banking services is underscored by recent economic growth[1], the opening of trade channels since the fall of the Taliban, and the injection of international aid. In response to that need, MISFA, through its 12 partner microfinance institutions (MFIs), has reached more than 82,000 clients to date, many of whom have received more than one loan.

In Afghanistan, at least 70% of the labor force works in the agricultural sector. Therefore, MFIs must cater to rural agricultural markets in spite of inherent risks and high costs. Reaching out to Afghan agricultural borrowers in remote areas demands that MFIs incur high transportation and transaction costs and they must also be prepared to work with a client base with seasonal income variations and collateral limitations. Most of their clients have no experience with formal lending institutions and credit. Despite these constraints, MISFA implementing partners have managed to maintain an overall repayment rate of over 99%.

In order to determine the breadth of agricultural lending and the potential demand, MISFA commissioned Altai Consulting to conduct a survey of five RAMP target provinces currently served by MISFA partners. Extrapolating from the report, MISFA estimates that of the 111,682 loans provided by the microfinance program, over 51,000 were agriculturally related.

SURVEY DEFINITIONS AND METHODOLOGY

In late 2004, Altai Consulting interviewed 975 borrowers receiving micro loans from three microfinance institutions. The amounts of the loans varied between $90 and $3,000. Borrowers interviewed received the loans from BRAC, CHF, and Mercy Corps/Ariana Financial Services, and were in the provinces of Balkh, Baghlan, Bamiyan, Kabul and Nangarhar.

The survey also identified income-generating activities, funded in whole or part through MISFA, that are contributing to Afghanistan's agricultural value chains. To date many MFIs in Afghanistan have employed varying definitions of 'agriculture-related businesses,' while still others classify businesses by type (service, trade, manufacturing) rather than sector.

The Altai survey captured, within a representative sample, MISFA micro entrepreneurs engaged in agribusinesses under the following RAMP definition:

> *"…rural producers and processors involved in any of the following activities: agriculture, livestock, or timber product market systems, including input supply, production, distribution, wholesaling, processing, and marketing/trading."*

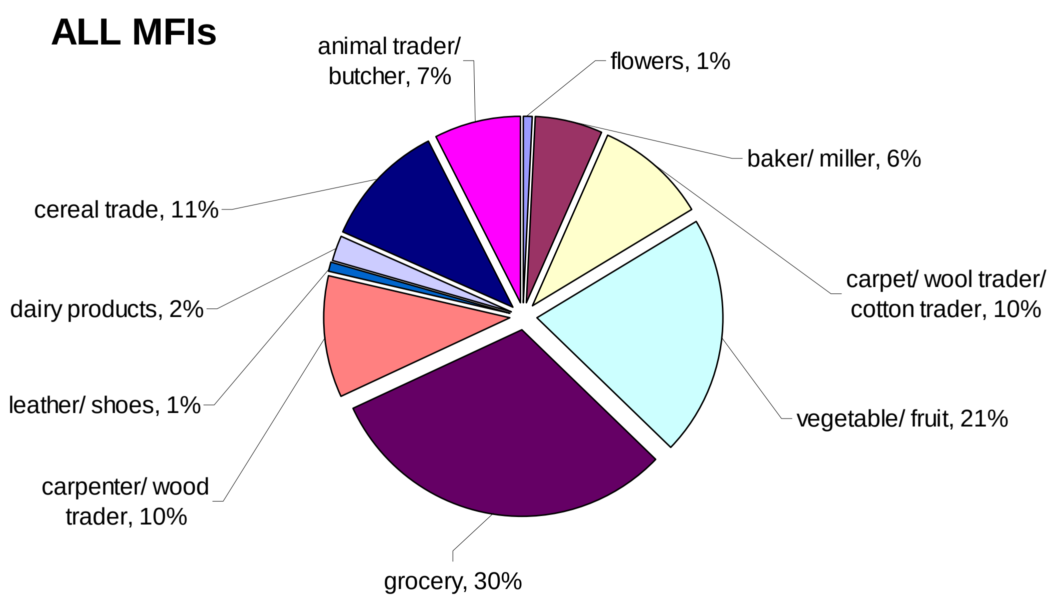
Altai surveyed non-agricultural clients to determine if and how clients had been misclassified. For most Afghan households, funds obtained through microfinance are combined with other resources

[1] World Bank 2002 estimate of 28%, Guimbert, Stephane.

and used to fund several activities. In this survey, households were reclassified as borrowers active in the agricultural sector only if the majority of loan funds went toward agricultural activities.

Survey Results: Quantitative Findings

Of the sample size (5.8% of borrowers), 46% of clients are classified in the agricultural sector. Borrowers previously classified in non-agricultural or under non-specific types of businesses include the following:



Large categories of borrowers, particularly traders, were classified into nonagricultural sectors. In general, retailing of fruits, vegetables, wool/cotton and cereals has not been counted as agricultural lending in MFIs reports. Wood traders and carpenters were also not classified within the agricultural sector.

Survey Results: Qualitative Findings

In addition to quantifying the number of micro entrepreneurs impacted through funds from USAID/RAMP, the survey also produced qualitative data. This data provided information about borrowers' satisfaction and expectations with MFIs providing the microloans. Eighty three clients were questioned about qualitative issues.

Usage. Most loans are used for working capital needs of the enterprise. Respondents believed loans were too small to be used to purchase assets or other capital improvements.

Source of Funds. Among the few that had alternatives, most clients preferred to borrow from the MFIs because of preferable rates. Respondents indicated that shopkeepers and large landholders charge higher fees, while loans from relatives and friends come with 'moral debt'.

Loans to Women. A majority of the qualitative interviews (82%) were conducted with female borrowers. However, in many of these interviews it was unclear who in the households were using the loans.

Designing Loan Products for the Agricultural Sector

The Altai survey reported that, in general, loan products by MFIs were considered inappropriate or too rigid for the needs of agricultural borrowers. Although complaints among microfinance borrowers are commonplace, particularly regarding interest rates, the report recommends a number of actions that MFIs can take to better reach clients in the agricultural sector. These include:

Amount. Loan amounts can be tailored to the costs of specific agricultural activities. For one MISFA-supported MFI, their average loan amount was equal to the cost of one goat. However, most MFIs increase their loan sizes as clients develop a positive credit history. "Step-crediting" is an important mechanism for encouraging on-time repayment.

Timing. MFIs designing larger loan products for the agricultural sector should consider timing of the repayments in accordance with the agricultural cycle. Grace periods can help accommodate agricultural borrowers, particularly at the start of the planting season. If not carefully timed, fluctuations in seasonal cash flow can cause large-scale problems for MFIs.

Term Limits. Terms on MISFA-supported loans, usually one year, were generally appropriate for agricultural sector borrowers. Although this prohibits funding for some livestock activities, tree crops, and equipment purchases, it is helpful to MFIs in managing the higher risk levels associated with agricultural lending.

Collateral. Collateral requirements on agricultural loans should include movable assets and group guarantees to remain inclusive to small shareholders.

APPLYING RESEARCH FINDINGS TO NEW MICROFINANCE PRODUCTS

Based on the Altai research, 46% of MFIs' portfolios include agricultural sector borrowers, although all of these clients are not completely captured in the MISFA reports. MISFA takes a more conservative approach when reporting on the number of agricultural borrowers impacted. RAMP is supporting further MISFA efforts to provide a wider outreach to the agricultural sector. MISFA is providing technical assistance and training to MFIs on the development of agricultural products, including loan product timing, acceptable forms of collateral, and evaluation of agricultural loans. This support will help MFIs target small shareholders, traders and as part of an initiative launched in April of 2005, Afghanistan's nomadic Kuchis. A few examples of innovative loan product development include:

Aga Khan Development Network (AKDN): Microfinance for Agribusinesses

To reach additional borrowers in rural Bamiyan, Badakhshan, Baghlan, Kunduz, and Takhar, the AKDN created two new agricultural lending products. ***Product #1, Lease-to-Purchase:*** Farmers receive training and can lease basic agricultural machinery, hand pumps, and veterinary equipment, with a nominal purchase price at the end of the lease term. The average loan size of $800 USD and 8-month loan term was designed in accordance with borrower needs. ***Product #2, Refinancing for Traders:*** targets dealers and traders providing farmers with inputs on credit. These dealers/traders frequently must wait until the end of the crop season for repayment, thus reducing their liquidity for purchasing inventory and growing their business. With this specifically designed microfinance loan, dealers can borrow an average of $1500 USD under flexible terms.

BRAC Microfinance for Agriculture and Livestock

BRAC's new agricultural and livestock development and credit support program will impact farmer income, create new employment, and increase agricultural activity. The program is specifically designed for farmers growing crops or raising poultry and/or livestock. The average loan amount is $200 - $300 with a one-year term for repayment. Technical assistance is provided to improve production and help farming families access loans up to $400

These efforts to improve agricultural lending in Afghanistan are important not only because of the large share of agricultural production within the larger economy, but also because farmers nationwide are seeking alternatives to poppy cultivation.

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